



CITY OF SANTA BARBARA

COUNCIL AGENDA REPORT

AGENDA DATE: March 16, 2004

TO: Mayor and Councilmembers

FROM: Planning Division, Community Development Department

SUBJECT: INCLUSIONARY HOUSING ORDINANCE

RECOMMENDATION:

That Council introduce and subsequently adopt, by reading of title only, An Ordinance of the Council of the City of Santa Barbara Amending Title 28 of the Santa Barbara Municipal Code by Adding a New Chapter to the Zoning Ordinance, Chapter 28.43 in Order to Enact an Inclusionary Housing Requirement for New Larger Residential Projects Within the City of Santa Barbara.

EXECUTIVE SUMMARY:

One of six strategies recommended by the Housing Action Task Force in 2001 was to develop an Inclusionary Housing Ordinance (IHO) aimed at large projects for the creation of ownership units affordable to middle income households. Therefore, under Council direction, Staff has developed the attached IHO with the main objective of generating affordable middle-income ownership units.

Staff is recommending introduction of the attached ordinance with the following key components:

1. The program would be applicable to residential ownership projects of ten or more units. Rental projects would be exempt;
2. A number of units equal to 15% of the proposed number of market units would be provided or "set aside" as restricted units affordable to middle income households;
3. The inclusionary units would target middle-income households with incomes between 120% to 200% of the Average Median Income, depending on unit type;
4. The required inclusionary units would be allowed as bonus units by right in addition to the market rate units allowed by zoning, subject to discretionary review of the design to assure neighborhood compatibility;
5. An in-lieu fee option would be available, based on the gap between the median price of two-bedroom condominiums and the price affordable to low income buyers;

REVIEWED BY: _____ Attorney

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6. In-lieu fees would be reduced on a sliding scale where the average size of the proposed market rate units is less than 1,700 square feet;
7. Alternative compliance mechanisms such as off-site production or land dedications could be permitted on a case-by-case basis subject to approval by the Planning Commission; and
8. The ordinance would apply to any project not deemed complete as of September 23, 2003; the day Council initiated the ordinance.

DISCUSSION:

Background

Staff has been developing an inclusionary program since early 2002, and a series of different options has been explored with the public, Housing Policy Steering Committee (HPSC), the Planning Commission, and Council. Staff also retained the services of Economic and Planning Systems (EPS) for technical assistance in developing the program. The framework for the proposed ordinance and program was presented to approximately 45 representatives of the building industry as well as interested citizens and decision makers at a public workshop on April 17, 2003.

Key considerations early on have been: the appropriate percentage or "set aside" requirement; project type and size; income levels targeted; developer incentives; alternative compliance mechanisms; and the length of affordability. A range of different options has been explored and presented throughout the process, including applying the program to projects with three or more units, five or more units, and ten or more units as well as sliding scales for in-lieu fee percentages. Early on, the Housing Policy Steering Committee discussed the pros and cons of these different options and recommended a 15% inclusionary requirement and a ten-unit project threshold.

On July 18, 2003, options including application of an IHO to projects with five, eight or ten more units were presented to the Planning Commission for their recommendation to the Council. Staff recommended a 15% inclusionary requirement for projects with ten or more units. The Planning Commission agreed, with a 5 to 1 vote, to recommend an IHO with the key components recommended by Staff. Subsequently, on September 23, 2003, on a 5 to 1 vote, the City Council supported the recommended components and initiated an inclusionary ordinance with a 15% inclusionary requirement and application to projects with ten or more units.

A draft ordinance was developed and forwarded to the Planning Commission for their final review and recommendation to the Council Ordinance Committee. Following is a summary of the Planning Commission and City Council Ordinance Committee recommendations on key policy considerations.

Planning Commission Review - December 18, 2003

The Planning Commission acknowledged that there has been extensive community involvement and discussion on the key components of the program and that they were not recommending starting over. A majority of the public speakers at the hearing were of the opinion that a 15% inclusionary requirement was too low and that some form of in-lieu fee

should apply to projects with fewer than ten units. Two members of the development community were in attendance, both of whom supported the use of bonus density for provision of the inclusionary units. One, however, stated that the in-lieu fees as proposed are too high.

The Commission made a motion and voted 6 to 1 to recommend the following to the Council Ordinance Committee:

1. Increase the 15% inclusionary requirement to 20%;
2. Apply the incentive of reduced in-lieu fees for smaller units to projects with market rate units of an average of 1,700 square feet or less, instead of 2,000 square feet or less as recommended by Staff;
3. Alternative compliance mechanisms that may be proposed by developers should be approved at the Planning Commission level and not at the City Council level;
4. The ordinance should provide some mechanism, such as the City having a right of first refusal to purchase the inclusionary units, to extend the expiration of the affordability period; and
5. The Commission requested that the Council consider and discuss a graduated in-lieu fee for projects of fewer than ten units.

Council Ordinance Committee – January 27 and February 3, 2004

The Committee heard from the public, who reiterated similar comments to those made at the Planning Commission hearing last December. Housing advocates recommended that the requirement be increased from 15% to 20%; that bonus density be allowed by right for the inclusionary units; that graduated in-lieu fees for smaller projects be applied; and that the units be affordable in perpetuity. Developers in attendance agreed that the use of bonus density is essential to making the program viable; however, they also expressed concern with the high cost of in-lieu fees; and opposed expanding the program to projects with fewer than 10 units.

The Ordinance Committee acknowledged that an increase from 15% to 20% also represented a 33% increase in the in-lieu fees, which would be a significant increase to fees, which are already high. They questioned why condominium units, required to sell to households between 120% to 160% of the AMI, could not be made available to upper middle-income households with incomes between 160% to 200%. Discussion among the Ordinance Committee also focused on preference for the inclusionary units going to people who live or work in the City, and that affordability in perpetuity (or increasing length of affordability to 60 years) be seriously explored on a broader scale when updating the City's Affordable Housing Policies and Procedures.

Following discussion, the Council Ordinance Committee forwarded the Draft IHO to the City Council with the following recommendations:

1. That the IHO apply to proposed projects with 10 or more units and require 15% affordability. This motion passed on a 2/1 vote. Chairperson Schneider opposed the

motion, preferring the inclusionary requirement be set at 20% for units constructed on site, but not applying the 20% factor to the in-lieu fee formula.

2. That the proposed in-lieu fee should not be extended, with a graduated formula, to apply to proposed projects with fewer than 10 units; and that alternative compliance proposals should be reviewed and approved by the Planning Commission, except for proposals that may raise major policy issues that should then be considered by the City Council. This motion passed on a 2/1 vote. Chairperson Schneider expressed support for the approach that alternative compliance proposals be reviewed and approved by the Planning Commission. Chairperson Schneider opposed the motion preferring that the graduated in-lieu fee should apply to projects with 5-9 units but be based on a formula where the in-lieu fees are reduced (using, for example, a moderate income affordability factor instead of a low-income factor).
3. That the Council direct staff to bring to Council, as part of the annual update of the City's Affordable Housing Policies and Procedures, background information, analysis and recommendations concerning the City's ability to impose "affordability in perpetuity" and to give "preference" on the sale/resale of affordable units to local residents and/or to persons employed locally but living elsewhere. This motion passed on a 3/0 vote.

Based on input from the public, the Planning Commission, and the Council Ordinance Committee, the attached Inclusionary Housing Ordinance has been developed. The key components are discussed below. Attachment 1 is a Table with the recommended inclusionary requirement.

Please note: the Area Median Income (AMI) has changed from \$60,600 to \$64,700 since last meeting with the Planning Commission and Council Ordinance Committee, therefore, all tables and discussion points that factor in the AMI have been adjusted to reflect the current AMI.

Key Ordinance Components Per Ordinance Committee Recommendation

Project Threshold: Throughout the process, direction has been that the project threshold should be aimed at "larger" projects, i.e., those with ten or more units proposed to be constructed or converted.

By targeting projects with ten or more units as the threshold, market rate units can better absorb the cost of an IHO. Smaller sites are typically more constrained and would also have fewer market units to absorb the cost of the inclusionary requirement. Staff's position has been to avoid making the program onerous for the projects with fewer units and minimizing impacts on the developer while maintaining a viable program. While members of the development community have expressed that the in-lieu fees as proposed are high, they have generally been supportive of the proposed ordinance.

Percent of Units to be Affordable: Early on, the HPSC recommended that 15% be adopted as the appropriate percentage for the inclusionary requirement given that a key consideration of this program was that it be viable for developers.

In Lieu Fee: The primary objective of the IHO is that affordable units be constructed on site. The in-lieu fee is proposed as an alternative available to developers when the

required affordable units cannot be accommodated on site. Currently, calculation of the in-lieu fee is the difference between the estimated production cost of a condominium unit and the price of a two bedroom affordable unit to a low-income household. The in-lieu fee option is purposely set high as a disincentive to paying the fee instead of building the units on site. The following table summarizes the recommended inclusionary unit requirements and in-lieu fees based on a 15% requirement as proposed.

Units in Project (w/o Dens. Bonus)	15%	Inclusionary Units Required	In-Lieu Fee if No Units Provided On-Site (based on \$310,000)
10	1.5	2	\$ 465,000
11	1.65	2	\$ 511,500
12	1.8	2	\$ 558,000
13	1.95	2	\$ 604,500
14	2.1	2	\$ 651,000
15	2.25	2	\$ 697,500
16	2.4	2	\$ 744,000
17	2.55	3	\$ 790,500
18	2.7	3	\$ 837,000
19	2.85	3	\$ 883,500
20	3	3	\$ 930,000
21	3.15	3	\$ 976,500
22	3.3	3	\$ 1,023,000
23	3.45	3	\$ 1,069,500
24	3.6	4	\$ 1,116,000
25	3.75	4	\$ 1,162,500

Reduction of In-Lieu Fee for Smaller Sized Units: As an incentive to encourage smaller sized units, Staff proposed a graduated in-lieu fee for projects that have market units averaging less than 2000 square feet. The Planning Commission has suggested the threshold for this incentive be reduced to 1,700 square feet. The following reductions of in-lieu fees are now incorporated into the ordinance:

Average Size of Market Units	In-Lieu Fee Reduction
1,400 – 1,699 s.f.	15%
1,100 – 1,399 s.f.	20%
800 – 1,099 s.f.	25%
Less than 800 s.f.	30%

Program Target – Middle Income Households: Given that the median sale price of a condominium is approximately \$500,000, and a single family residence approximately \$800,000, less than 5% of all City households earn the minimum of \$195,000 annual income necessary to purchase a home of \$800,000. The IHO, as applied to residential condominium projects, is designed to target middle-income households; that is, those with

incomes between 120% to 160% of the Area Median Income (AMI). In Santa Barbara County, the AMI is \$64,700 for a household of four. Therefore, the middle-income units generated through the proposed Inclusionary Housing Program would sell to households with annual incomes of between \$77,640 and \$103,520 for a household of four. Currently, the target maximum sale price for a two-bedroom condominium for middle-income households would be \$272,000.

The ordinance would allow for projects with detached units on separate lots to target upper-middle income households, that is, those with incomes between 160% and 200% of AMI. Currently, the income range for a four-person household would be between \$103,520 and \$129,400. The maximum sale price for a two-bedroom detached house on a separate lot would be \$376,000.

Use of Density Bonus: The proposed ordinance will allow the developer to provide required inclusionary units through the use of the City's density bonus program. For example, a developer proposing a residential project on a lot zoned for a maximum of 10 units would be required to provide two affordable inclusionary units. In meeting this obligation, the developer could construct 12 units on the site, enabling the cost of the two affordable units to be distributed among the 10 market rate units.

In difficult cases where site constraints exist and providing the inclusionary units would prove infeasible, the applicant will have the option to pay the in-lieu fees, a combination of inclusionary units and in-lieu fees, or pursue other alternative compliance mechanisms. The IHO can work in conjunction with the City's recently revised Density Bonus Program. Like the proposed ordinance, the City's Density Bonus Program requires (in most ownership cases) that the units be affordable for sale to middle income households.

Alternative Compliance Mechanisms: Staff had recommended that alternate compliance mechanisms, other than the in-lieu fee, be reviewed on a case-by-case basis by the City Council. The Commission and Council Ordinance Committee were of the opinion that applicants should work out solutions at the Planning Commission level appealable to the City Council. In those rare cases where a policy decision is necessary they would be forwarded to the City Council.

Affordable Time Period: Currently, the draft ordinance requires that the units be affordable for a period of 45 years. If there were a change in ownership before the 45 years expire, a new affordability control covenant would be created with a new 45-year renewal term. It is Staff's understanding that currently, the maximum time period a unit would remain as an affordable unit is 90 years, assuming changes in ownership have occurred. Commissioners, the public, and Council Ordinance Committee have expressed concerns that once the 45 years (in the case of one owner for 45 years) or when 90 years are up, these units would revert to market rate units, and the value to the community would end.

Based on the Planning Commission and Council Ordinance Committee's recommendation to explore perpetuity or at a minimum extending the affordability period to 60 years, the ordinance has been amended to specify that the affordable time period shall be consistent with the City's Affordable Housing Policies and Procedures. This issue will be further evaluated during the next annual update of the City's Affordable Housing Policies and Procedures.

Possible Alternative Ordinance Components

Alternative 1, Project Threshold Lowered to 5 Units with a Graduated in Lieu Fee:

Throughout the process, concerns have been raised about the unintended consequence of applicants proposing projects below the threshold requirement. For example, if the threshold were ten units, applicants would build nine units instead of ten. One option brought before the Council Ordinance Committee was a graduated in-lieu fee that would apply to projects with less than ten units as suggested by the Planning Commission. One member of the Council Ordinance Committee was supportive of this option.

While graduated in lieu fees for projects with fewer than ten units is not recommended, Staff has prepared Alternative 1 on Attachment 1 that shows graduated in-lieu fees for projects between five and nine units for a 15% inclusionary requirement. For example, a five-unit project would pay 50% less of the standard in-lieu fee, a six-unit project would pay 40% less, etc. Also, if in the case of a 5-9-unit project it were more feasible for the applicant to provide one inclusionary unit on site, they would have that option available.

Alternative 2, Percent of Units to be Affordable Increased from 15% to 20%: A 15% requirement, when applied to large projects of ten units or more, would be more financially feasible for developers than a 20% set aside requirement. Increasing the set aside requirement from 15% to 20% would have a significant impact on the proposed in-lieu fee structure. Attachment 1 includes tables showing the 15% and 20% requirement for required affordable units as well as in-lieu fees. Using a ten-unit project as an example, the inclusionary requirement would be two affordable units in both cases; however, the in-lieu fee would increase from \$465,000 to \$620,000 or a \$155,000 difference. A 33% increase in the in-lieu fees as was proposed by the Planning Commission, was a significant policy decision that the Council Ordinance Committee considered before recommending a 15% requirement as recommended by Planning Staff. Included on Attachment 1 is also Alternative 2 showing graduated in-lieu fees for projects between five and nine units for a 20% inclusionary requirement.

Alternative 3, Inclusionary Unit Percentage Increased to 20% but Maintain In-Lieu Fees at a Lower Level: One combination of options discussed by the Committee was to increase the affordable units to 20% and maintain the in-lieu fees at a 15% level. Alternative 3 on Attachment 2 bases the fee on the difference between the estimated production cost of a condominium unit and the price of a two bedroom affordable unit to a *moderate income* household, which is roughly equivalent to the in-lieu fees under a 15% affordability requirement (as shown on Alternative 1) and affordable to a *low income* household.

Staff is concerned that any option that would render the in-lieu fee option more attractive than building the units on site could undermine the entire program. If the in-lieu fees are not significantly higher than the cost of constructing the units on site, developers might simply opt to build larger market rate units and pay the in-lieu fee. The fees should be set high enough either to discourage developers from paying the in-lieu fee or to enable a city to finance construction of an equivalent number of affordable units elsewhere.

Staff does not recommend lowering the in-lieu fees, however, for purposes of discussion included on Attachment 2 is a comparison between the 15% and 20% in-lieu fees that would be required based on a formula factoring affordability to low or moderate income households.

Extend Eligibility for Middle-Income Units to Upper Middle-Income Households: Members of the Planning Commission and Council Ordinance Committee asked why condominiums targeted to sell to families with 120% - 160% of the AMI could not be made available for families with upper middle incomes (160% to 200% of the AMI). This would result in middle-income households, earning 120% - 160% of the AMI, competing with upper middle-income households for the few units that would be affordable to the standard middle-income households. This could further diminish the chances for typical middle-income households to acquire the few units affordable to them. Staff does not support this policy in that it would be inconsistent with the City's adopted Affordable Housing Policies and Procedures.

ENVIRONMENTAL REVIEW:

The proposed amendment to the Municipal Code qualifies for a Categorical Exemption under California Environmental Quality Act (CEQA) Guidelines §15305, Minor Alterations in Land Use Limitations. Included in the allowable projects and actions which the City has determined to be consistent with this exemption class are the "creation of minor new, and minor amendments to existing land use plans, ordinances, guidelines, regulations and/or development standards which do not result in any changes in land use or density and which have no potential for significant environmental effects." The inclusionary units would be primarily in-fill units as allowed by zoning and the new units to be generated would be no greater than what could be allowed under current State and City Density Bonus programs.

Current information from the State Department of Finance indicates that there are approximately 37,236 housing units in the City. The City General Plan and Zoning Ordinance designations allow for a maximum residential build-out of approximately 40,005 housing units. This estimate recognizes implementation of existing City housing policies, including those addressing preservation of housing in commercial areas, bonus density units for affordable housing, increased mixed-use development downtown, and higher allowable densities in some areas through the use of variable density standards. The theoretical build-out of 40,005 units has been documented and evaluated over time in many City policy and resource studies.

The new ordinance would require a total of 15% of the proposed units to be provided as restricted or "set aside" units affordable to middle income households. The inclusionary units would be allowed as bonus density units by right in addition to the market rate units allowed by zoning. The 15% bonus density increase is less than the 25% mandated under State density bonus law. An in-lieu fee and other compliance mechanisms would also be available as options to property owners.

Based on historical trends and projects currently in the process, Staff estimates that approximately 71 restricted middle-income units could be generated from the IHO over the next ten years. As stated above, the maximum residential build-out of approximately 40,005 housing units included bonus density units for affordable housing. The IHO would work in conjunction with the City's existing density bonus program and therefore, the additional potential units that may be generated from the IHO fall well within the 40,005 residential units that have been previously analyzed.

Also, project-specific impacts, including any effects associated with aesthetics, historic resources, archaeology, air quality, water quality, traffic, etc., would be assessed as part of the environmental review completed for each individual housing project as it is processed.

BUDGET/FINANCIAL INFORMATION:

Planning Division Staff currently reviews all applications for tentative subdivision maps as well as any bonus density projects for ownership units as part of the standard planning process. The additional review required with the adoption of an inclusionary housing ordinance as proposed is not anticipated to significantly impact this review given that development applications will be incremental. However, some additional staff time may be necessary to analyze and complete research on these types of applications. Should the Council expand the ordinance by lowering the threshold to fewer than ten units, the smaller projects will increase the request for lot area modifications. It is anticipated that these services could be provided within the existing level of service.

RECOMMENDATION:

One of the implementation strategies of the 2004 Housing Element is to consider adopting an inclusionary housing program to meet the housing needs of those not currently served by City Housing and Redevelopment Agency programs. The Housing Element has identified that housing needs for middle-income households is a major issue for approximately 10,700 middle-income households. The objective of the attached ordinance is to develop a set of clear requirements to generate restricted middle-income units while still maintaining project feasibility. While it is understood that the proposed ordinance would not solve all of the housing problems it would be an important tool for generating affordable middle income units for households that have not historically qualified for affordable housing nor can typically afford the market rate housing prices in the city. Therefore, Staff recommends that the Council introduce and subsequently adopt the proposed new inclusionary housing ordinance.

ATTACHMENTS: 1. Tables with Alternatives 1 and 2
2. Tables with Alternatives 1 and 3

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APPROVED BY: City Administrator's Office